

RODNEY SCHMIDT

# The Currency Transaction Tax

RATE AND REVENUE ESTIMATES



**THE CURRENCY  
TRANSACTION TAX:  
RATE AND  
REVENUE ESTIMATES**

*Rodney Schmidt*



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# **I N T R O D U C T I O N**

The Currency Transaction Tax (CTT) is one of the new mechanisms being considered by governments, international institutions, and others to raise large amounts of independent, global, and stable monies.<sup>1</sup> The new revenues are to be used to finance international development and other projects addressing global issues, such as public health. Each of the new financial mechanisms (described in Table 4 of section 3.4) poses the same two questions: is it feasible? (meaning, is it cost-effective?; are there negative side-effects?); and, how much money would it raise? We and others showed elsewhere that the CTT is feasible (section 1.2). Here we identify an appropriate CTT rate: high enough to raise lots of money but low enough to avoid changing fundamental market behavior. We also estimate revenues when the CTT is applied either unilaterally to a single major currency (the \$, €, ¥ or £), or coordinated across several of these currencies.

## **N o t e**

1. More than 50 heads of state and 200 senior ministers, as well as the heads of the United Nations (UN), International Monetary Fund (IMF), World Bank (WB), and World Trade Organization (WTO), attended the UN International Conference on Financing for Development at Monterrey, Mexico, in 2002. The Conference began a search for new sources of development finance, led formally by the UN Department

of Economic and Social Affairs (<http://www.un.org/esa/ffd/>), and informally by more than 40 governments participating in the “Leading Group on Solidarity Levies to Fund Development” (<http://www.innovativefinance-oslo.no/>).

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# The Currency Transaction Tax: Rate and Revenue Estimates

**Rodney Schmidt**

The Currency Transaction Tax (CTT) is emerging as a leading new financial instrument for governments seeking to raise large amounts of global, independent, and stable monies. These funds are needed for international development and projects addressing global issues such as public health and climate change. Key questions in developing the CTT are: what should be its rate, how much money would it raise, and how would it affect foreign exchange markets?

In this study, Rodney Schmidt exploits the fact that the CTT, which has not yet been implemented, is functionally equivalent in foreign exchange markets to the bid-ask spread: both are transaction costs. The immediate effect of a CTT newly applied would be to increase bid-ask spreads. To see how the tax would operate in the market, then, he examines statistically the historical relationship between bid-ask spreads and the volume of foreign exchange transactions. Based on this relationship, his goal is to identify a tax rate that can raise a lot of money without disrupting the market. He finds that, at a rate of 0.5 basis points (0.005%), post-implementation changes in spreads and transaction volumes would be well within normal experience. A CTT of 0.5 basis points would raise at least US\$33 billion each year.

The CTT is a feasible new source of revenue for development and other global projects. It is safe and easy to implement, and can immediately raise at least US\$33 billion of global, independent, and stable revenue each year. The CTT therefore appears to be the most immediate and effective new source of financing sought by the Monterrey Conference on Financing for Development in 2002, and, since then, by the UN and the "Leading Group on Solidarity Levies to Fund Development."

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